

Message Text

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FM AMEMBASSY JAKARTA
TO SECSTATE WASHDC 6880
INFO AMEMBASSY BANGKOK
AMCONSUL HONG KONG
AMEMBASSY KUALA LUMPUR
AMEMBASSY MANILA
AMCONSUL MEDAN
AMEMBASSY SINGAPORE
AMCONSUL SURABAYA
AMEMBASSY TOKYO

C O N F I D E N T I A L SECTION 1 OF 4 JAKARTA 2155

HONG KONG FOR TREASURAY ATTACHE SHARPE

E.O. 11652: GDS
TAGS: ENRG, ID EALR
SUBJECT: INDONESIAN PETROLEUM SECTOR OUTLOOK, 1978

1. SUMMARY: INDONESIAN OIL PRODUCTION IN 1978 IS EXPECTED TO
DECLINE TO AN AVERAGE OF ABOUT 1.61 MILLION BARRELS PER DAY.
EXPLORATION, ESPECIALLY IN NEW AREAS, IS PICKING UP SUBSTANTIALLY,
BUT WILL HAVE TO CONTINUE TO INCREASE IF EXPECTED PRODUCTION
DECLINE IS TO BE REVERSED IN EARLY 1980'S. JOINT VENTURE CON-
TRACT HAS BEEN SUCCESSFUL IN STIMULATING EXPLORATION, BUT
FURTHER INCENTIVES APPEAR NECESSARY TO ATTRACT NEEDED NEW IN-
VESTMENT. PERTAMINA IS CONSIDERING NEW INCENTIVES, BUT THERE
IS OPPOSITION TO THEM BY SENIOR GOVERNMENT POLICY OFFICIALS.
NINETEEN SEVENTY-SEVEN WAS PROBABLY INDONESIA'S LAST YEAR
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OF LARGE INCREASES IN OIL PRODUCTION AND EARNINGS. EVEN
BEST CASE ASSUMPTIONS ABOUT OIL FUTURE SUGGEST NO SUB-
STANTIAL GROWTH IN THE PETROLEUM SECTOR'S RELATIVE SHARE
OF GOVERNMENT BUDGET REVENUE AND FOREIGN EXCHANGE
EARNINGS. MUCH OF THE DATA IN THIS TELEGRAM IS INFORMA-
TION PROVIDED ON CONFIDENTIAL BASIS BY U.S. PETROLEUM
COMPANIES AND PERTAMINA. PLEASE PROTECT. END SUMMARY.

2. PRODUCTION: EMBASSY ESTIMATES 1978 INDONESIAN OIL PRODUCTION TO AVERAGE ABOUT 1.60-1.62 MILLION BARRELS PER DAY, AS COMPARED WITH ACTUAL 1977 PRODUCTION OF ABOUT 1.68 MILLION BARRELS PER DAY AND PERTAMINA FORECAST OF ABOUT 1.56-1.58 MILLION BARRELS.

3. WE REGARD GOI'S BUDGET FORECAST OF 1.56 - 1.58 MILLION BARRELS PER DAY AS CONSERVATIVE LARGELY DUE TO PERTAMINA'S AND FOREIGN COMPANIES' UNDERSTANDABLE TENDENCY TO SUBMIT FIGURES TO FINANCE SECRETARIAT THEY ARE 90 PERCENT SURE CAN BE MET; THEREBY AVOIDING EMBARRASSING PROBLEM OF NOT MEETING THEIR OWN PROJECTIONS. THE GOI BASED ITS BUDGET FORECAST ON PERTAMINA'S SUBMISSION: CONTRACT OF WORK PRODUCTION 750,000 BARRELS PER DAY; PRODUCTION-SHARING CONTRACT PRODUCTION 710,000 BARRELS PER DAY; AND PERTAMINA'S OWN PRODUCTION 100,000 BARRELS PER DAY. OUR DISCUSSIONS WITH THE COMPANIES SUGGEST THEY GENERALLY SUBMITTED LOW PRODUCTION ESTIMATES TO PERTAMINA, AND AT LEAST IN ONE IMPORTANT CASE IT IS LIKELY PERTAMINA FURTHER DAMPENED THE ESTIMATE IN ORDER TO PROVIDE ITSELF AN ADDITIONAL MARGIN OF ERROR WITH THE FINANCE MINISTRY. PERTAMINA IS CLEARLY AWARE OF RESULTING CONSERVATIVE NATURE OF THE FORECAST, BUT FOR POLITICAL AND BUREAUCRATIC REASONS BELIEVES IT IS BETTER TO EXCEED EXPECTATIONS RATHER THAN TO RISK COMING UP SHORT.

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4. EMBASSY'S OWN INVESTIGATIONS SUGGEST 1978 INDONESIAN PRODUCTION WILL BE ABOUT 1.60-1.62 MILLION BARRELS PER DAY ON AVERAGE AND WE BELIEVE THIS FIGURE, SUBJECT TO A PLUS OR MINUS ERROR OF 2 TO 3 PERCENT, IS SOUND FORECAST. IT IS MUTUALLY REINFORCING DESIRE OF THE COMPANIES AND PERTAMINA TO BE ON THE SAFE SIDE OF THE MINUSFACTOR THAT HAS RESULTED IN THE CONSERVATIVE 1.56-1.58 MILLION BARRELS PER DAY FIGURE.

5. A CASE IN POINT IS THE IMPORTANT CALTEX PRODUCTION THAT ACCOUNTS FOR ABOUT 50 PERCENT OF INDONESIA'S TOTAL OIL OUTPUT. COMBINED CALTEX PRODUCTION AVERAGED ABOUT 833,000 BARRELS PER DAY IN 1977, DOWN FROM 870,000 BARRELS PER DAY IN 1976. THE GOI BUDGET ANALYSIS USES 750,000 BARRELS PER DAY AS LIKELY CALTEX OUTPUT IN 1978. (THIS INCLUDES SMALL STANVAC CONTRACT OF WORK PRODUCTION ALSO.) HOWEVER, CALTEX FIELD GEOLOGISTS AND ENGINEERS INDICATE THIS FIGURE IS "EXTREMELY LOW" AND IT ASSUMES MAXIMUM DOWN TIME FOR EQUIPMENT AND FACILITIES AND LIMITED SUCCESS FOR ENHANCED RECOVERY TECHNIQUES IN ARRESTING THE ADMITTEDLY SERIOUS DECLINE RATE IN THE LARGE

MINAS FIELD. THIS FIGURE DOES NOT TAKE INTO ACCOUNT THE RECENT AND AS YET UNOFFICIAL AGREEMENT BETWEEN CALTEX AND PERTAMINA THAT WILL PERMIT CALTEX TO PROCEED WITH ITS EXPANDED SECONDARY RECOVERY PROGRAM. WE BELIEVE CALTEX (AND STANVAC) 1978 PRODUCTION IS LIKELY TO BE IN THE 770,000-790,000 BARRELS PER DAY RANGE.

6. EMBASSY'S FORECAST OF 1.60-1.62 MILLION BARRELS PER DAY AVERAGES INCLUDES 780,000 BARRELS PER DAY FROM CALTEX, 740,000 FROM PRODUCTIN-SHARING AREAS, AND 90,000 FROM PERTAMINA WHICH IS THE CASE OF ITS OWN PRODUCTION FORECAST MAY HAVE BEEN INFLUENCED BY ITS HOPE TO PRODUCE IN SIX FIGURES. WE CAUTION THAT OURESTIMATES INCLUDE A PLUS OR MINUS FACTOR OF ABOUT 3 PERCENT AND
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THAT BY USING DAILY AVERAGES THE FORECASTS APPEAR MORE OPTIMISTIC THAN AN ACTUAL COMPOSITE PRODUCTIN CURVE JUSTIFIES. CURRENTLY, PRODUCTION IS STILL ABOUT 1.7 MILLION BARRELS PER DAY AND WE BELIEVE BY END OF 1978 IT MAY BE ABOUT 1.57 BARRELS PER DAY AND DECLINING.

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7. THERE ARE NO SIZEABLE OIL FIELDS SCHEDULED TO COME ONSTREAM IN 1978, ALTHOUGH SOME NEW SMALL FIELDS WILL BE HOOKED UP, AND CONTINUED DEVELOPMENT DRILLING WILL HELP ARREST THE STEEP DECLINE RATES CHARACTERISTIC OF MOST INDONESIAN FIELDS.

8. DEVELOPMENT DRILLING: AFTER THE "RENEGOTIATION" OF CONTRACTS IN 1976, MOST PRODUCTION-SHARING COMPANIES VIRTUALLY CEASED NEW INVESTMENT IN EXPLORATORY WORK, BUT CONTINUED TO DEVELOP THEIR ALREADY PRODUCING FIELDS. THIS HELPED SUSTAIN THE RISE IN TOTAL PRODUCTION THROUGH 1977. HOWEVER, IT SHOULD BE RECOGNIZED THAT IN PRODUCTION-SHARING AREAS DEVELOPMENT DRILLING IS ULTIMATELY A FUNCTION OF FINDING NEW FIELDS, AND WITH THESE IN SHORT SUPPLY IN 1977 AND 1978, DEVELOPMENT DRILLING CAN BE EXPECTED TO DECLINE. FOLLOWING ARE FIGURES FOR DEVELOPMENT-
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MENT WELLS IN 1976, 1977 AND PROJECTIONS FOR 1978:

	1976	1977	1978 (ESTIMATED)
PRODUCTION SHARING	152	113	103
CONTRACT OF WORK	115	170	173

WE NOTE THAT PLANNED DEVELOPMENT DRILLING IN PRODUCTION-SHARING AREAS IN 1977 WAS 126 WELLS AND REALIZED DEVELOPMENT WELLS FELL SHORT OF THAT, SUGGESTING THAT 1978 RESULTS MAY ALSO BE LOWER THAN THE PLANNED 103.

9. RESERVES: THE DEBATE OVER INDONESIA'S RECOVERABLE RESERVES CONTINUES. GOI HAS SET UP A SPECIAL TEAM LODGED IN MIGAS TO EVALUATE THE COUNTRY'S FUTURE PRODUCTION POTENTIAL. OUR DISCUSSIONS WITH MEMBERS OF THIS TEAM INDICATE AN "OPTIMISTIC ASSESSMENT" IS LIKELY TO EMERGE SOMETIME THIS YEAR WITH THE FIGURE OF 15 BILLION BARRELS OFTEN MENTIONED. MIGAS DIRECTOR WIJARSO HAS TOLD EMBASSY HE IS MORE OPTIMISTIC ABOUT INDONESIA'S LONG-TERM OIL FUTURE THAN HE WAS ONLY A YEAR AGO. AFTER DISCUSSING THE RESERVE ISSUE WITH PERTAMINA, GOVERNMENT, AND COMPANY GEOLOGISTS, EMBASSY CURRENTLY FEELS "GEOLOGICAL AGNOSTICISM" ABOUT INDONESIA'S ULTIMATELY RECOVERABLE RESERVES IS MORE APPROPRIATE POSITION THAN "GEOLOGICAL PESSIMISM." THE RANGE OF "INFORMED" OPINION IS FROM ABOUT 8 BILLION BARRELS TO 17 BILLION BARRELS. A SENIOR U.S. GEOLOGIST, EXPLAINING THE SYSTEM BY WHICH RESERVES ARE ESTIMATED, NOTED TWO DIFFERENT GEOLOGISTS USING THE SAME DATA COULD COME UP WITH ESTIMATES AS MUCH AS 50 PERCENT APART. THUS NOT ONLY

IS LEVEL OF UNCERTAINTY HIGH, BUT EXPERIENCE SUGGESTS
 THAT BECAUSE OF DEFINITIONAL AMBIGUITIES AND VESTED
 INTERESTS, SOME OF THE FIGURES USED IN THE PAST ARE
 REALLY MORE PART OF NEGOTIATING PROCESS BETWEEN THE
 GOVERNMENT AND COMPANIES THAN SERIOUS RESERVE ESTIMATES.
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FOR PURPOSES OF THIS EVALUATION, WE ASSUME INDONESIA
 HAS PETROLEUM RESERVES IN SUFFICIENT QUANTITY SO
 THAT THEY ARE NOT A CONSTRAINT ON MAINTAINING PRODUCTA
 ION AT OR NEAR CURRENT LEVELS THROUGH MID-1980'S,
 PROVIDED SUFFICIENT INVESTMENT IN EXPLORATION AND DEVELOP-
 MENT IS FORTHCOMING.

10. EXPLORATION EXPENDITURE: EXPLORATION IN INDONESIA
 IS EXPECTED TO INCREASE SIGNIFICANTLY IN 1978 COMPARED
 TO 1977. FOLLOWING IS DATE ON SEISMIC WORK AND EXPLOR-
 ATORY DRILLING IN 1976 AND 1977 AND PLANNED FIGURES FOR
 1978, AS WELL AS EXPLORATORY EXPENDITURES FOR 1976,
 1977 AND PLANNED FOR 1978.

	1976	1977	1978 (ESTIMATED)
SEISMIC WORK (SQ. KILOMETERS)			
PRODUCTION SHARING	19,097 KM	11,526 KM	8035 KM
CONTRACT OF WORK	742 KM	1,280 KM	500 KM
EXPLORATORY WORK			
PRODUCTION SHARING	109 WELLS	83 WELLS	117 WELLS
CONTRACT OF WORK	24 WELLS	24 WELLS	16 WELLS
EXPLORATORY BUDGET EXPENDITURES (IN MILLION DOLLARS)			
PRODUCTION SHARING	\$231,338	\$136,023	\$202,783
CONTRACT OF WORK	\$9,255	\$26,730	

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11. THE PLANNED INCREASE IN EXPLORATORY EXPENDITURES AND DRILLING IN 1978 IS SUBSTANTIAL WHEN COMPARED TO DE-PRESSED LEVELS OF 1977, BUT BASIC ISSUE IS WHETHER THE INCREASES ARE SUFFICIENT TO FIND AND DEVELOP NEW RESERVES NECESSARY TO ARREST OR REVERSE THE DECLINE IN PRODUCTION EXPECTED IN 1978 AND 1979. OUR PRELIMINARY JUDGEMENT IS THAT THE LEVEL OF EXPLORATORY WORK PLANNED FOR 1978 IS NOT SUFFICIENT, BUT THAT IF THE RATE OF INCREASE OF EXPLORATION CONTINUES THROUGH 1979 AND 1980, THERE IS A GOOD CHANCE, BASED ON OUR ASSUMPTIONS ABOUT RESERVES, THAT NEW DISCOVERIES CAN BEGIN OFFSET DECLINES.

12. ACTUAL EXPLORATION IN 1979 MAY EXCEED PLANNED LEVELS GIVEN ABOVE. WE NOTE PLANNED SIESMIC WORK IN 1977 FOR PRODUCTION-SHARING AREAS WAS 2691 KM., WHILE REALIZED WAS 11,526 KM. AND PLANNED EXPLORATORY DRILLING
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WAS 45 WELLS, WHILE REALIZED WAS 83. AN ADDITIONAL ENCOURAGING NOTE IS THE TRADITIONAL YEAR-END DIP IN EX-PLORATORY WOEK DID NOT OCCUR IN NOVEMBER-DECEMBER 1977. HOWEVER, IT IS ALSO IMPORTANT TO RECOGNIZE REAL CON-STRAINTS ON INCREMENTS TO EXPLORATORY DRILLING INCLUDING BUDGET PARAMETERS AND UNAVAILABILITY OF EQUIPMENT. (JACK UP RIGS IN PARTICULAR ARE VIRTUALLY UNAVAILABLE IN AREA NOW.) WE BELIEVE IT IS LIKELY EXPLORATORY WORK IN 1978 WILL EXCEED PLANNED LEVELS, BUT IN THE CASE OF DRILLING NOT BY MORE THAN 10 TO 15 PERCENT.

13. GREATER EMPHASIS ON EXPLORATION IN NON-PRODUCING "WILDCAT" AREAS SHOULD CHARACTERIZE 1978 ACTIVITIES. SOME COMPANIES, SUCH AS CITIES SERVICE AND PETROMER TREND, ARE IN THE LAST YEAR OF MEANINGFUL EXPLORATION UNLESS THEY STRIKE NEW OIL, BUT MANY MORE COMPANIES ARE MOVING INTO NEW CYCLE OF EXPLORATION WITH THE LARGEST INCREASES TO TAKE PLACE IN IRIAN JAYA -- ONE OF THE FEW AREAS HERE THAT SOME GEOLOGISTS BELIEVE MAY CONTAIN RE-

LATIVELY LARGE, UNTAPPED OIL FIELDS. TOTAL, CONOCO AND AMOSEAS WILL BE INITIATING WORK IN IRIAN JAYA IN 1978 IN ADDITION TO TREND'S "LAST LOOK" AND PHILLIPS' ONGOING EXPLORATION OF ITS AREA, WHICH INCLUDES THE PRODUCING SALAWATI FIELD. INDONESIA'S OIL PATCH WILL BE WATCHING CLOSELY THE RESULTS OF IRIAN JAYA EXPLORATION AND INDICATIONS OF SUCCESS WOULD SPUR EVEN GREATER INTEREST IN THE AREA.

14. EMBASSY DOES NOT BELIEVE THE "HIGH SUCCESS RATIO" FOR DRILLING IN INDONESIA CAN BE USED TO JUSTIFY FORECASTS THAT EXISTING LEVELS OF EXPLORATORY AND DEVELOPMENT DRILLING WILL PREVENT A DECLINE IN PRODUCTION. THERE IS AN ILLUSORY QUALITY TO THESE RATIOS BECAUSE CALTEX EXPLORATORY AND DEVELOPMENT WORK RESULTS
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IN VERY HIGH PERCENTAGE OF SUCCESSES DUE TO THE ABILITY TO FIND AND DEVELOP VERY SMALL FIELDS NEAR THE INTENSIVE INFRASTRUCTURE DEVELOPMENT OF ITS LARGE CENTRAL SUMATRA AREA. ALSO, EVEN IN DISCUSSING SUCCESS RATIOS, THE ABSOLUTE NUMBERS ARE IMPORTANT. INDONESIAN FIELDS ARE GENERALLY SMALL AND SIX SUCCESSES OUT OF EIGHT TRIES THAT FIND 15 MILLION BARRELS OF OIL IN EACH SUCESS ADDS UP TO LESS THAN ONE SUCCESS IN TEN TRIES THAT FINDS A FIELD OF 150 MILLION BARRELS. DRILLING IN PRODUCTION-SHARING AREAS, WHERE MOST ADDITIONS TO RESERVES MUST BE FOUND, IS MORE RISKY THAN IN CENTRAL SUMATRA; AN EXTREME EXAMPLE BEING THE RECENTLY INAUGURATED SALAWATI FIELD WHERE 18 DRY WELLS PRECEDED DISCOVERY OF THE FIELD.

15. CONTRACTS AND INCENTIVES : INDONESIA'S BASIC PRODUCTION-SHARING CONTRACT TERMS RETAIN THE 85-15 SPLIT. HOWEVER, NUMEROUS MODIFICATIONS MADE LAST SPRING HAVE IMPROVED THE BOTTOM LINE OPPORTUNITIES FOR THE CONTRACTORS AND PART OF THE INCREASE IN EXPLORATORY ACTIVITY REFLECTS THIS. WE SEE LITTLE CHANCE OF NEW INCENTIVES BEING OFFERED UNTIL AFTER THE PRESIDENTIAL ELECTION AND EXPECTED CABINET RESHUFFLING. EVEN THEN, IT IS UNLIKELY THE 85-15 RATIO WILL BE CHANGED.

16. THE JOINT VENTURE CONTRACTS (WHICH MAKE AVAILABLE TO FOREIGN COMPANIES ON-SHORE AREAS PREVIOUSLY RESERVED FOR PERTAMINA) OFFERED FOR THE FIRST TIME IN 1977 HAVE BEEN SUCCESSFUL IN HELPING PICK UP THE PACE OF PLANNED EXPLORATION WORK DESPITE CONTINUED LACK OF ENTHUSIASM FOR THIS TYPE OF CONTRACT BY MOST COMPANIES. DEMINEX, THE GERMAN STATE-SUPPORTED OIL COMPANY, IS REPORTED READY TO SIGN A CONTRACT FOR A NORTHEAST KALIMANTAN AREA AND WILL JOIN CONOCO AND TOTAL (BOTH IN IRIAN JAYA) AS JOINT VENTURE CONTRACTORS. PERTAMINA PLANS TO OFFER MORE

AREAS UNDER THIS ARRANGEMENT IN 1978, INCLUDING THIS
WEEK A SOUTH SUMATRA BLOCK THAT IS CONSIDERED ATTRACTIVE.
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OTHER SUMATRA AREAS WILL PROBABLY BE OFFERED LATER THIS
YEAR. WHILE WE JUDGE THE JOINT VENTURE CONTRACTS SUCCESSFUL IN STIMULATING EXPLORATION, THERE ARE OBVIOUS
LIMITS TO IT. THE MOST IMPORTANT CONSTRAINT IS THE
SMALL NUMBER OF PROMISING AREAS THAT CAN CONTINUE TO
ATTRACT COMPANY BIDS IN SPITE OF THE RATHER TIGHT CONTRACT TERMS. ADDITIONAL JOINT VENTURE OFFERINGS WILL
NOT IN THEMSELVES BE SUFFICIENT TO GENERATE RATES OF INCREASE IN EXPLORATORY INVESTMENT REQUIRED TO OFFSET
DECLINES IN PRODUCTION.

17. LOOKING TO THE FUTURE, PERTAMINA PROBABLY WOULD LIKE
INTRODUCE SOME NEW INCENTIVES IN 1978. HOWEVER, THIS
DESIRE IS NOT COMPLETELY SHARED BY KEY GOVERNMENT POLICY
OFFICIALS WHO BELIEVE MAINTENANCE OF CURRENT TERMS IS
SUFFICIENT ECONOMICALLY AND IMPORTANT POLITICALLY.
DESPITE ABSENCE OF CONSENSUS ON THIS POINT, PERTAMINA IS
HOLDING INTERNAL DISCUSSIONS DESIGNED TO IDENTIFY POSSIBLE INCENTIVES THAT DO NOT ALTER BASIC 85-15 SPLIT.
NOT SUPRISINGLY, PERTAMINA TENDS TO FOCUS ON FURTHER
INCENTIVES FOR ALREADY IDENTIFIED "SPECIAL AREAS" OF (A) SMALL
FIELDS, (B) EXPLORATION IN INACCESSIBLE REGIONS, AND (C)
ENHANCED RECOVERY PROGRAMS, AS WELL AS POSSIBLE INCENTIVE
PACKAGE FOR DEEP WATER EXPLORATION. OTHER POSSIBILITIES
INCLUDE MAKING RELINQUISHED AREAS AVAILABLE UNDER SOME
NEW ARRANGMENT AND GREATER USE OF FOREIGN COMPANIES

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STRAIGHT "COST PLUS SHARE OF PRODUCTION" BASIS TO STIMULATE EXPLORATION ON JAVA.

18. IRS TAX RULING: U.S. COXMPANIES ARE PROCEEDING WITH INVESTMENT PLANS BASED ON ASSUMPTION IRS IS ABOUT TO ISSUE REVISED RULING THAT WILL NOT ALTER PRESENT U.S. TAX TREATMENT OF PAYMENTS TO GOI. PERTAMINA ALSO ASSUMES SUCH A RULING IMMINENT AND IS CONSIDERING WAYS OF USING ITS MANAGEMENT CONTROL OVER NEW CONTRACTS, WORK PLANS, AND RELINGUISHMENTS IN ORDER TO NEUTRALIZE AS MUCH AS POSSIBLE THE FISCAL AND INCENTIVE EFFECTS OF INDONESIA'S TAX CHANGES. INDONESIA FINANCE OFFICIALS PROJECT "MINIMAL" REVENUE IMPACT ON GOI EARNINGS, THANKS TO "GRAND-FATHER CLAUSE" ON CONSILIDATION AND TO ANTICIPATED SUCCESS OF PERTMINA ACTION TO PREVENT POSSIBLE COMPANY GAINS AT EXPENSE OF GOI. PERTAMINA PRESIDENT HARYONO WANTS TO CONFIDENTIAL

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NEUTRALIZE EFFECTS OF TAX CHANGES, NOT ONLY TO PREVENT REVENUE LOSS TO GOI, BUT ALSO TO BE ABLE TO RESERVE THE FULL TAX BENEFITS OF CONSOLIDATION FOR USE AN INCENTIVE IN FUTURE CONTRACT NEGOTIATIONS WITH COMPANIES.

19. INDONESIA'S OIL BONANZA IS OVER: THE SAME GOI BUDGET PRESENTATION THAT INCLUDED OIL PRODUCTION FORECAST OF 1.56-1.58 MILLION BARRELS PER DAY ALSO ENVISIONED MODERATE (4 TO 6 PERCENT) INCREASES IN TAX REVENUE AND FOREIGN EXCHANGE EARNINGS FROM OIL SECTOR. THIS APPARENT PARADOX HAS BEEN PARTLY RATIONALIZED BY NOTING 1978 LNG EARNINGS OF ABOUT \$100 MILLION ARE INCLUDED AND THAT A LARGER SHARE OF 1978 OIL PRODUCTION WILL BE HIGHER PRICED CRUDES. THESE ANSWERS DO NOT SATISFACTORILY EXPLAIN THE SITUATION AND OUR OWN RESEARCH SUGGESTS GOI REVENUE FORECASTS WERE BASED ON PLANNED 5 PERCENT INCREASE IN WORLD PRICE OF OIL WHICH DID NOT OCCUR. THE INCONGRUITY BETWEEN PROJECTED OIL REVNUES ANDPROJECTED OIL PRODUCTION BECOMES LESS IMPORTANT WHEN EMBASSY FORE-

CAST OF 1.60-1.62 MILLION BARRELS PER DAY IS SUBSTITUTED FOR GOI'S. HOWEVER, RISING DOMESTIC CONSUMPTION OF OIL AND OIL PRODUCTS, ESTIMATED AGAIN AT ABOUT 12 PERCENT FOR 1978, WILL CONTINUE TO EAT INTO INDONESIA'S OIL EXPORTS.

20. THE POLITICALLY SENSITIVE SUBSIDIZED PRICES OF KEROSENE AND OTHER OIL PRODUCTS MAY HAVE TO BE INCREASED DURING 1978. GIVEN A FORECAST 12 PERCENT GROWTH IN DOMESTIC FUEL CONSUMPTION, THE ALLOCATED BUDGET SUBSIDY OF 59 BILLION RUPIAH (\$142 MILLION) IS INSUFFICIENT TO COVER THE PROJECTED GAP BETWEEN PRODUCTION COSTS AND SALES REVENUES. PERTAMINA OR THE MINISTRY OF FINANCE MAY HAVE TO COVER AN ADDITIONAL 60 BILLION RUPIAH (\$145 MILLION). INDONESIA'S TOP ECONOMIC OFFICIALS HAVE AL-

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READY RECOMMENDED A PRICE HIKE OF ABOUT 35 PERCENT TO TAKE PLACE NEXT SUMMER. HOWEVER, FOR POLITICAL REASONS THIS DATE HAS NOW BEEN PUSHED BACK TO NEXT SEPTEMBER OR OCTOBER. EVEN THEN IT MAY BE DIFFICULT FOR THE POLITICAL LEADERSHIP TO BITE THE BULLET ON THIS ISSUE.

21. ALL INDICATIONS ARE THAT 1977 WAS LAST YEAR OF LARGE INCREASES IN INDONESIA'S OIL PRODUCTION AND EARNINGS, AND BEGINNING IN 1978 PRODUCTION WILL DECLINE AT LEAST TEMPORARILY. AS DISCUSSED EARLIER IN THIS ASSESSMENT, IT IS CONCEIVABLE THIS DECLINE CAN BE REVERSED, BUT IT IS NOT CERTAIN. UNDER THE BEST CIRCUMSTANCES, INDONESIA, IN THE EARLY 1980'S, MAY RESTORE OR SLIGHTLY INCREASE EXISTING PRODUCTION LEVELS. THERE IS ALMOST NO PROSPECT OF REPEATING THE VERY LARGE RATES OF INCREASE IN OIL PRODUCTION AND EARNINGS THAT CHARACTERIZED THE BONANZA PERIOD OF 1971 THROUGH 1977 IN WHICH PRODUCTION DOUBLED AND OIL PRICES INCREASED FIVE-FOLD. IN THE FUTURE, THE RELATIVE SHARE OF THE OIL SECTOR'S CONTRIBUTION TO BUDGET AND FOREIGN EXCHANGE EARNINGS CAN BE EXPECTED TO DECLINE. THE "NEGATIVE" OF THIS IS THAT THE OIL SECTOR CAN NO LONGER BE COUNTED ON TO GENERATE THE EARNINGS THAT MADE POSSIBLE MASSIVE INCREASES IN GROWTH OF CONSUMPTION AND INVESTMENT IN PAST YEARS DESPITE SUBSTANTIAL MISMANAGEMENT AND LEAKAGES AS INDICATED BY THE PERTAMINA DISASTER. THE "POSITIVE" IS THAT OVERALL ECONOMIC POLICY MAY BE SOMEWHAT FREED FROM THE SEDUCTIVE BUT OFTEN DISTORTING GRIP OF AN OIL BOOM, THEREBY PERMITTING THE GOI TO ADDRESS MORE REALISTICALLY INDONESIA'S FUNDAMENTAL PROBLEMS ASSOCIATED WITH IMPROVING FOOD PRODUCTION, CREATING JOBS, PROMOTING NON-OIL EXPORTS, AND RELIEVING INCOME DISPARITIES. THE POLICIES OF ADJUSTMENT TO THE CHANGE IN OIL EXPORT EARNINGS, HOWEVER, WILL BE DIFFICULT.

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Message ID: f5f9a2d4-c288-dd11-92da-001cc4696bcc
Office: ACTION EA
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 10
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: n/a
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 02 may 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 3564176
Secure: OPEN
Status: NATIVE
Subject: INDONESIAN PETROLEUM SECTOR OUTLOOK, 1978
TAGS: ENRG, EALR, ID
To: STATE
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/f5f9a2d4-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
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EO Systematic Review
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